

April 1997

CONTRACT MANAGEMENT

Fixing DOD's Payment Problems Is Imperative



19970520 029



United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-272540

Contract Management
Fixing DOD's Payment Problems is
Imperative

April 10, 1997

The Honorable John Glenn
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable Tom Harkin
United States Senate

The Honorable Peter A. DeFazio
The Honorable Carolyn B. Maloney
House of Representatives

In response to your request, we reviewed the Department of Defense's (DOD) efforts to improve its contract payment practices. Specifically, we looked at (1) the factors contributing to payment errors and increased costs, (2) DOD's efforts to improve its payment system, and (3) payment practices of commercial companies that DOD might adopt. This report focuses on the payment of contracts administered by the Defense Contract Management Command (DCMC) and paid by the Defense Finance and Accounting Service's (DFAS) Columbus Center. As part of our effort to identify innovative practices that might be applicable to DOD's contract payment process, we concentrated on those of four non-federal entities—Electronic Data Systems, Boeing, ITT Automotive, and the University of California, Berkeley.

In recent years, we have reported on DOD's numerous problems in making accurate payments to defense contractors. These reports identify millions of dollars in government overpayments, underpayments, and interest on late payments, in addition to other financial management problems. For example, during a 6-month period in fiscal year 1993, the Center processed \$751 million in checks returned by defense contractors. Our examination of \$392 million of the \$751 million disclosed that about \$305 million, or about 78 percent, represented overpayments by the government. Subsequently, we found that some contractors had retained overpayments. For example, in one case, a contractor was overpaid \$7.5 million due to numerous errors. The overpayment remained outstanding for 8 years. We estimate that government interest lost on the overpayment amounted to nearly \$5 million. We concluded that neither DOD nor the responsible contractors appeared to be aggressively pursuing resolution of payment discrepancies.

DTIC QUALITY INSPECTED 2

Results in Brief

It is imperative that DOD achieve cost-effective control over its payment process. Otherwise, it continues to risk hundreds of millions of dollars in potential overpayments and other financial management and accounting control problems. Further, improving the efficiency of the payment process would save additional millions of dollars annually in reduced processing costs.

The following factors contribute significantly to problems and increased costs in DOD's payment process: (1) nonintegrated computer systems that require manual entry of data that is erroneous or incomplete, (2) multiple documents that must be matched before contractors are paid, and (3) payments that require allocation among numerous accounting categories.

Improving DOD's payment system will not be an easy or quick undertaking. It will require continued top management attention and support for many years to come. While DOD is taking some steps to address its payment problems, when and to what degree they will effectively correct its problems remains to be seen. Further, DOD's actions do not go far enough in addressing the factors we identified as contributing to payment problems. For example, DOD has yet to decide on how to minimize transferring existing erroneous data to the new automated system. Moreover, it also plans to continue to match multiple documents and allocate payments across numerous accounting categories.

Our review indicated that DOD might benefit from further examining best practices of commercial organizations that have reengineered their contract payments process. The organizations we visited have focused on a long-term effort of continual improvements with contract payments viewed as an integral part of the acquisition process. In general, these organizations have combined technological improvements with streamlined processes to improve service and reduce costs.

In light of our findings to date we are making recommendations to enhance DOD's strategy for addressing its contract payment problems.

Background

Contracting officers typically delegate to DCMC responsibility for administering contracts when they require delivery or supply of centrally managed military- or agency-unique items or services. Such contracts can range in size from small purchases (under \$25,000), which are typically

completed within a few months, to multibillion dollar weapon systems development and production contracts that take years to complete.

In January 1991, DOD established DFAS to assume responsibility for DOD finance and accounting. DFAS' Columbus Center pays contracts administered by DCMC. For fiscal year 1995, these contract payments amounted to 37 percent of the dollars, and 5 percent of the invoices paid by DOD. The Center's computer system contained contract administration and financial data on about 376,000 contracts as of September 1995. The financial data in the Center's payment system is not, however, the official accounting record for the contracts. Rather, approximately 190 accounting stations maintain the official accounting records. The Center had 1,440 employees, who processed 1.2 million invoices and disbursed \$61 billion in fiscal year 1995.

The Center makes two basic types of contract payments—delivery payments and financing payments. About two-thirds of all payments are delivery payments for goods and services; the balance is financing payments. Financing payments are made on both cost reimbursement and fixed-price contracts as contractors incur costs and submit billings. Financing payments on fixed-priced contracts—called progress payments—are later credited against delivery payments when items are delivered, a process called progress payment liquidation. The type of payment made will affect how the transaction is processed.

DOD recognizes it has serious, long-standing problems in correctly disbursing billions of dollars in payments and providing reliable accounting information. DOD identified this as a high-risk area in its February 1996 Federal Managers' Financial Integrity Act report. We have also identified DOD contract management, including contract payments, as a high-risk area.¹

Factors Contributing to Contract Payment Process Errors and Cost

We identified three key factors that contribute significantly to problems in DOD's payment process. These three factors are:

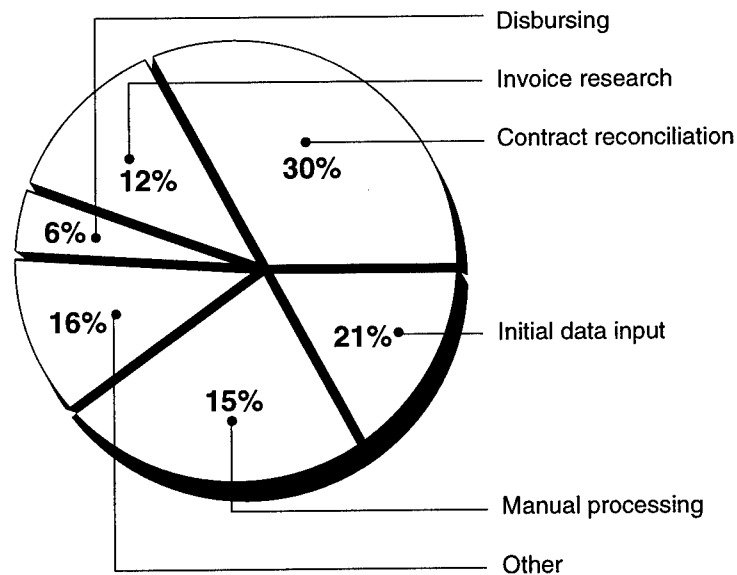
- nonintegrated computer systems that require data to be entered manually and often with information that is erroneous or incomplete,
- multiple documents that must be matched before contractors are paid, and
- payment information that is allocated among numerous accounting categories.

¹High Risk Series: Defense Contract Management (GAO/HR-97-4, Feb. 1997).

Although there may be other factors contributing to DOD's payment problems, such as the complexity of contracting requirements for major weapon systems, our review indicated that addressing the three factors is key to DOD's ability to improve payment accuracy and reduce costs.

These factors increase costs by increasing manual data input, invoice research, contract reconciliation, and manual payment processing. Figure 1 illustrates that a large portion of the Columbus Center's reported invoice processing cost are consumed by these functions. For fiscal year 1995, the Center reported that it cost an average of \$87 to process a contract invoice, \$44 of which was direct labor.²

Figure 1: Activity Cost Analysis by Contract Payment Function



Source: Based on DFAS Columbus Center MOCAS BPR Assessment, KPMG Peat Marwick, LLP, August 1995.

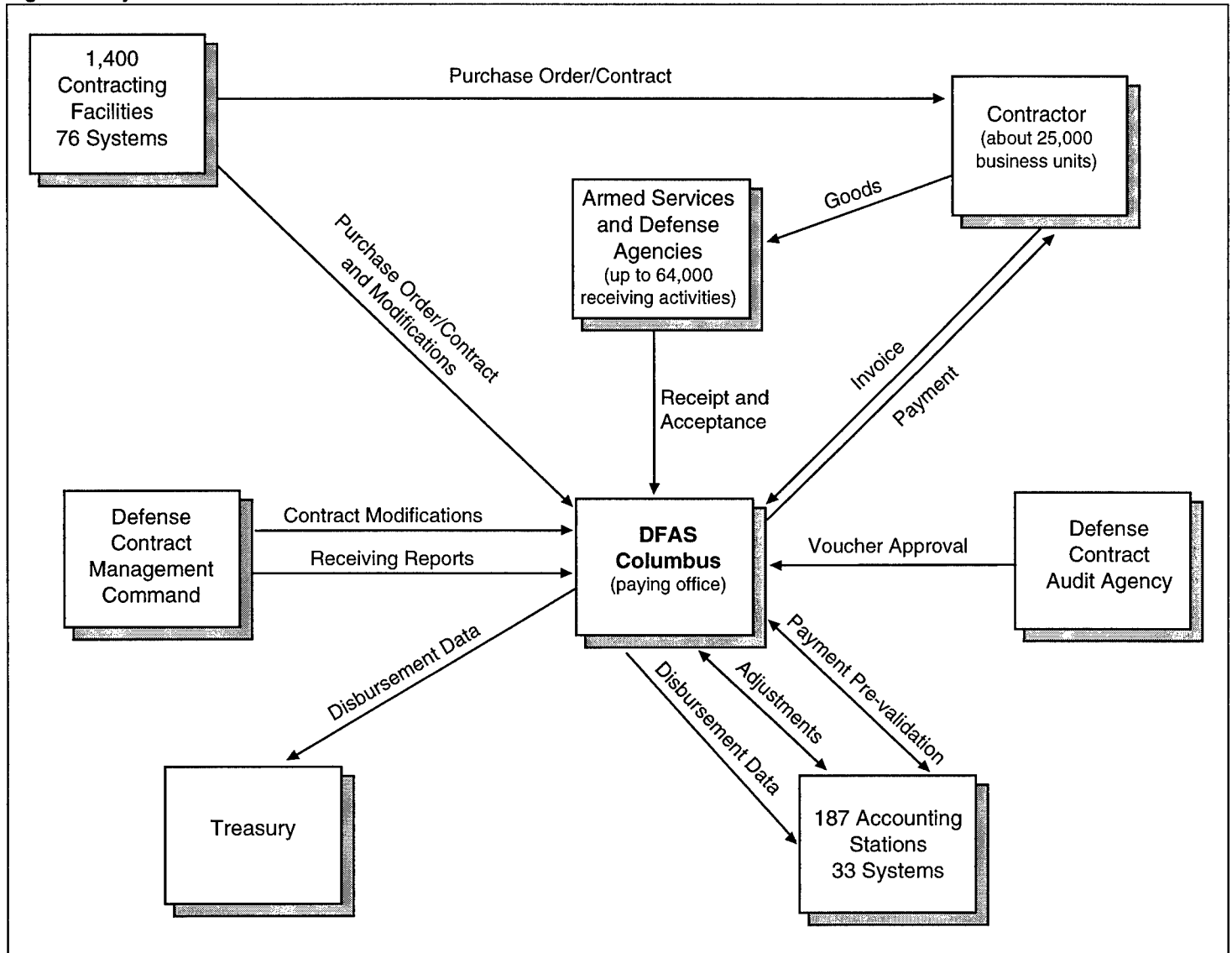
²We did not verify or validate the accuracy of the Center's reported data. However, in February 1996, DOD acknowledged that accurate and complete cost accounting information is a serious DOD-wide weakness.

Nonintegrated Computer Systems Often Require Manual Data Entry

Manual entry of contract data into the payment system adds significantly to processing costs. Generally, other DOD activities, such as purchasing and accounting, provide most of the data to DFAS (see fig. 2). However, because DOD's payment system is not integrated with DOD's procurement and accounting systems, much of the data they generate cannot be electronically transferred to the payment system and must be manually entered from hard copy documents.³ Even when data is electronically transmitted, it often is incomplete or inaccurate. Furthermore, because of a perceived high error rate of electronic transmissions, many DFAS data clerks enter data manually, according to DOD.

³According to DOD, several of the major procurement offices do not have the capability to make electronic transmissions.

Figure 2: Payment Process Information Flow



Source: GAO.

Because the systems are not integrated, the payment process is highly paper dependent. According to a file room supervisor at the Columbus Center, the Center files about 25,000 loose contract documents a week. A consulting firm's study noted that the Center's paper dependent workflow

has frequently led to misrouted and misplaced paper documents.⁴ This condition delays payments and further increases processing costs. According to DOD, it made a decision in 1995 to implement the government and industry standard for electronic transmissions to eliminate the manual data entry of contract data into its accounting and payment systems. The Center is testing the use of these transmissions in some of its divisions. However, manual entry may still be required in certain situations, such as contracts with special clauses.

The Document Matching Process Consumes Time and Resources

Before making payments, Columbus Center employees match a number of documents to ensure the payments are in accordance with the purchase order and that funds are available to cover payments. For both delivery and finance payments, Center employees match at least the purchase order, the invoice, and the obligation records contained in the Center's payment system.⁵ For delivery payments, they also match to the receiving document. Although time consuming, matching is intended to ensure that items ordered were received and that funds have been obligated and are available to make the payment.

According to DOD officials, the matching to obligation records is performed to avoid violating the Anti-Deficiency Act.⁶ Among other things, that act provides that a government employee may not make an expenditure (payment) exceeding the amount in an appropriation or fund available for that purpose. When a contract is signed, an obligation is recorded, which essentially reserves sufficient appropriated funds until payments become due. Center employees match an invoice to contract obligations recorded in the Center's payment system to verify the availability of funds before making a payment. The obligation records used by Center employees, however, are not DOD's official accounting records. For payments over \$5 million, the Center is also required to verify funding availability in the official accounting records maintained at the accounting stations.⁷

The Center tries to pay invoices automatically, and it did so for about half of its payments in fiscal year 1995. However, if Center employees are unable to verify or match payment data to its records (invoices, purchase

⁴DFAS Columbus Center MOCAS BPR Assessment, KPMG Peat Marwick, LLP, August 1995.

⁵An obligation is a binding commitment that will require an expenditure at some later time from an appropriation.

⁶31 U.S.C. 1341.

⁷Section 8137 of Public Law 103-335, Department of Defense Appropriations Act, 1995.

orders, receiving documents, Center obligation records, or accounting station records), they are required to research discrepancies before making payment. An inability to match payment data causes Center employees to manually process payments, which can cost up to seven times more than an automated payment.

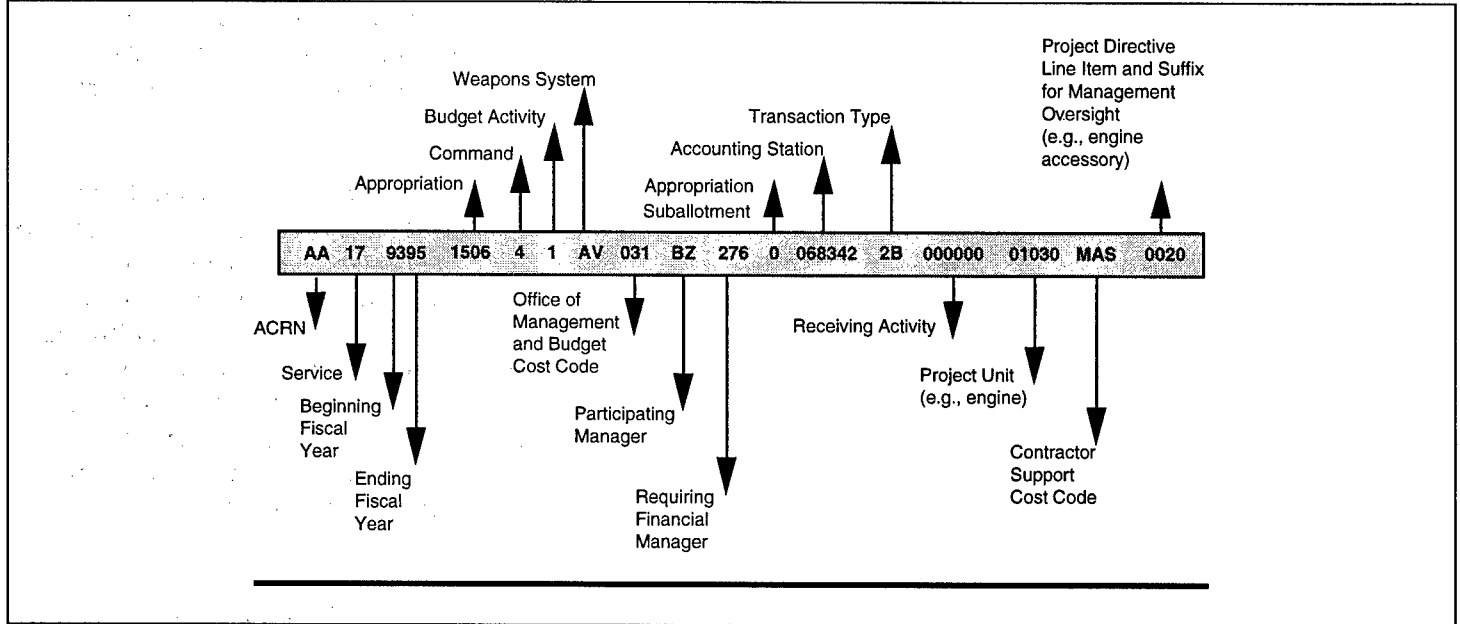
Mismatches can also cause the Center to have to reconcile a contract—an extensive and costly process that can take from several hours to years. For example, on a contract valued at \$1.2 billion, the Center's and the accounting station's disbursement records differed by \$12 million. In addition, both the Center's and the accounting station's records differed from the contractor's records. The Center and a public accounting firm engaged by the Center have spent about 5 years off and on attempting to reconcile this contract. While the costs for reconciling this contract were not available, DOD paid the public accounting firm about \$8.6 million in fiscal year 1996 for contract reconciliation support on numerous contracts.

Efforts to resolve mismatches through invoice research, contract reconciliation, and manual processing account for about 57 percent of average payment costs. About one-third of the Center's contract payment personnel are dedicated to invoice research and contract reconciliation.

Payment Allocations Can Be Inaccurate, Misleading, and of Questionable Value

DOD uses a "long line of accounting" to accumulate appropriation, budget, and management information for contract payments. For all contracts, the buying activity assigns a two-character code called an accounting classification reference number (ACRN) to each accounting line containing unique information. The Center allocates payments to ACRNs in an attempt to ensure that the payments comply with the requirements of the Anti-Deficiency Act. Figure 3 is an example of an accounting line—the type and quantity of information varies among the services.

Figure 3: Example of DOD's Long Line of Accounting



Source: DOD.

Contracts can be assigned anywhere from 1 to over 1,000 ACRNs. A contract with numerous ACRNs may involve extensive data entry, increasing the chance for errors and manual payment processing. Manual payment processing costs an average of \$15 per ACRN, according to a consulting firm's study.

According to a DFAS official, contracts with 10 or more ACRNs are more likely to have payment problems. Our review showed that of the 217,000 active contracts, about 3 percent have 10 or more ACRNs, but they account for 77 percent of the total value, as shown in table 1.

Table 1: Number of ACRNs Per Contract

Dollars in billions				
Number of ACRNs	Number of contracts	Percent of contracts	Value of contracts	Percent of value
1	174,087	80	\$29.7	5
2 to 9	35,846	17	116.4	18
10 to 100	6,523	3	327.4	51
101 to 1,000	448	*	164.1	26
more than 1,000	4	*	0.9	0
Total	216,908	100	\$638.5	100

* Less than 1 percent.

Source: GAO analysis of "active" contracts from DOD's Mechanization of Contract Administrative Services (MOCAS) system, March-April 1996.

When buying activities assign numerous ACRNs, payment allocations to the ACRNs can be time consuming and may not provide useful or reliable management information. For example, in one case we reviewed, a single payment on a contract with many ACRNs took 6 to 8 hours to process. The contractor, required to bill by ACRN, took 487 pages to assign \$2.1 million in costs and fees to 267 ACRNs. Ten of the ACRNs cited by the contractor had insufficient obligation balances to cover the payment, according to the Center's records. The remaining 257 ACRNs corresponded to 8 annual appropriations covering from 1 to 5 fiscal years and included Army, Air Force, and general defense funds. Of the 257 transactions processed, 38 were for less than \$10, and some involved debits or credits for pennies. Unresolved discrepancies, such as insufficient funds on some ACRNs, have persisted for about 3 years, and the contract is currently scheduled for reconciliation. The contractor believes the contract was underpaid by about \$2.6 million, as of September 1996.

Even for a simple purchase, assigning numerous ACRNs can cause extensive and costly rework, and provide information of questionable management value. For example, a \$1,209 Navy contract for children's toys, candy, and holiday decorations for a child care center was written with most line items (e.g., bubble gum, tootsie rolls, and balloons) assigned a separate ACRN. A separate requisition number was generated for each item ordered, and a separate ACRN was assigned for each requisition. In total, the contract was assigned 46 ACRNs to account for contract obligations against the same appropriation. To record this payment against the 1 appropriation, the Center had to manually allocate the payment to all

46 ACRNS. Figure 4 is an actual portion of this contract showing the ACRNS assigned to each item.

Figure 4: Contract Excerpt

ITEM NO.	SUPPLIES OR SERVICES	QUANTITY ORDERED	UNIT	UNIT PRICE \$	AMOUNT \$
0025	HALLOWEN PINBALL GAME - FA380 Accounting and Appropriation Data: BF 1751805 61C0 548 62585 0 062863 2D 5RK001 PPO05026K179 PR #: N62585-5026-K179	5.00	DZ	1.750000	8.75
0026	PUMPKIN BANK - BB28 Accounting and Appropriation Data: BG 1751805 61C0 548 62585 0 062863 2D 5RK001 PPO05026K180 PR #: N62585-5026-K180	5.00	DZ	9.500000	47.50
0027	DINOSAUR PENCIL TOPS - 1545L Accounting and Appropriation Data: BH 1751805 61C0 548 62585 0 062863 2D 5RK001 PPO05026K181 PR #: N62585-5026-K181	5.00	DZ	1.500000	7.50

Source: DOD.

The contract was modified three times—twice to correct funding data and once to delete funding for out-of-stock items. The modification deleting funding did not cite all of the affected ACRNS. The Center made errors in both entering and allocating payment data, compounding errors made in the modification. Consequently, the Center allocated payment for the toy jewelry line item to fruit chew, jump rope, and jack set ACRNS—all of which should have been deleted by modification. Contract delivery was completed in March 1995, but payment was delayed until October 1995. Center officials acknowledged that this payment consumed an excessive amount of time and effort when compared to the time to process a payment charged to only one ACRN. The contract could have been assigned a single ACRN, according to a Navy official, thus making it easier to pay without losing useful information. A single ACRN would also have

significantly reduced the amount of data entered into the system and the opportunities for errors.

In addition, sometimes contracts do not require contractors to provide the accounting detail necessary to allocate the payments. In these instances, the Center prorates payments among ACRNS. These prorations have little relationship to the contractor's actual performance and may cause funds to be initially paid from the wrong appropriation. As an example, the Center's proration of development and procurement costs on an Army contract understated the development expenditures of the contractor. According to a DOD program official, the understatement frustrated the program office's initial request for additional development funding because the Army's official accounting records incorrectly showed adequate development funds as being available. The DOD Inspector General identified the proration issue as a problem in March 1992, and DFAS is attempting to resolve the issue with the Inspector General.⁸

Allocating progress payments can also contribute to later payment problems when the Center liquidates progress payments. As items are delivered and the actual charges to the various ACRNS become known, Center employees adjust the amounts previously prorated against the ACRNS. They also incrementally cancel the debt the contractor owed the government for the contract financing it received. This adjustment process is known as liquidation of contract financing. In 1995, we reported that errors in liquidating progress payments were the most frequent cause of overpayments identified by Columbus Center analysis.⁹ Due to the complex issues involved, we have undertaken a separate review of progress payment processing.

User requirements for detailed accounting can place unreasonable or unachievable demands on the payment system. Moreover, DOD's current pricing structure does not reflect the time it takes DFAS to meet user requirements. Thus, the user has little incentive to critically evaluate the level of detail being required and its associated costs.

Commercial Best Practices

The four organizations we visited have reported significant improvements in service and reductions in cost by reengineering their payment systems and adopting process improvements. These organizations have

⁸Titan IV Program (92-064 Mar. 31, 1992), DOD, Office of the Inspector General.

⁹DOD Procurement: Millions in Contract Payment Errors Not Detected and Resolved Promptly (GAO/NSIAD-96-8, Oct. 6, 1995).

emphasized the need to approach payment reengineering as a long-term effort focusing on continual improvement and viewing contract payments as part of the total acquisition process. The outcome of their reengineering efforts, according to these organizations, combined technological improvements with streamlined processes and included:

- consolidating and centralizing payment organizations;
- developing fully integrated automated systems and using electronic data interchange;
- implementing simplified processes, to include eliminating one of three documents typically used to make a payment; and
- using alternative procurement practices, such as use of purchase cards, for smaller purchases.

More details on the results of our visits to four nonfederal organizations is discussed in appendix I.

Two of the private-sector organizations we visited had available processing costs. They reported that reengineering reduced their direct labor costs to process a contract payment to less than \$3—a 30- to 50-percent reduction. Moreover, the organizations we visited reported that payment productivity increased. For example, one reported that the annual number of invoices processed per full-time employee equivalent (FTE) increased from about 8,500 to 16,400, a 93-percent increase. In contrast, the Columbus Center processes an average of about 1,000 invoices per individual per year.¹⁰

DOD Is Addressing Its Payment Problems, but It Can Do More

DOD is aware of the seriousness of its payment problems and is taking steps to address them, including testing and adopting some commercial best practices. In the shorter term, DOD is attempting to further automate the payment process and is testing streamlined payment practices. Its longer-term initiative involves the development and introduction of procurement and payment systems that will share common data. While these are positive steps, there are other actions DOD can take to better ensure it effectively addresses and resolves its payment problems, to include further exploring the best practices used by organizations to reengineer their payment systems.

¹⁰Based on about 1.2 million invoices paid divided by the total payment personnel in the Center's disbursing section and three payment directorates. FTE data was not available.

DOD's Contract Payment Initiatives

DOD is developing two systems to replace 76 procurement and 8 payment systems. The procurement and payment systems are expected to share common data, thus providing one-time entry of contract data, including invoice and receiving and acceptance documents. By doing this, DOD expects to eliminate redundant data entry, data inconsistencies, and hard copy dependence. The payment system, according to DOD, is scheduled for implementation in fiscal year 1999 and both systems are planned to be fully operational by fiscal year 2004.

While DOD is developing these systems, DFAS is taking other steps to automate its payment process and reduce manual entry. DFAS' initiatives include:

- upgrading the Columbus Center's existing payment system with electronic data interchange (EDI) capabilities so that several of DOD's present contract writing systems can transmit data electronically;
- implementing a software application that automates a portion of the manual payment process;
- implementing document imaging, which converts hard copies to electronic images;
- increasing the use of electronic funds transfer;¹¹ and
- developing a capability to electronically access contract and modification information from a single source using DOD's private network.

DOD also has efforts to streamline its payment processes. It continues to expand its use of the purchase card¹² and has formed two teams to recommend better ways for using the card. In addition, in August 1996, the Naval Air Systems Command (NAVAIR) directed its program managers to limit the collection of financial and budgetary information. By doing so, it hopes to simplify contracts by reducing the number of ACRNS.

DOD has other initiatives to streamline the payment process for contracts not administered by DCMC. If successful, a DOD official said it may apply them to DCMC-administered contracts. For example,

- The Los Angeles Air Force Base is planning a pilot to eliminate invoices for purchases under \$100,000. It wants to use bar code and EDI technology

¹¹Per the Federal Financial Management Act of 1994 (31 U.S.C. 3332, as amended by P.L. 104-134), all federal payment must be made by electronic funds transfer after January 1, 1999. The Secretary of the Treasury may waive the requirement for certain types of payments or payees.

¹²According to DOD, during the first quarter of fiscal year 1997, the card was used to make 935,750 purchases valued at \$410 million.

to transmit receipt information to the DFAS-Denver paying office, match information to the purchase order, and trigger payments. The Defense Commissary Agency eliminated the need for an invoice in 1994, and, according to DOD, achieved significant savings.

- The DFAS-Denver paying office plans to pay for certain purchases under \$2,500 without matching to a receipt. It intends to control payments by auditing a sample of paid invoices.

Additional Actions Needed

While DOD's initiatives are positive steps and may improve its payment process efficiency and reduce costs, there are additional steps DOD needs to take as it implements its strategy for improving its contract payment system.

While DOD plans to improve the linkage between the payment and procurement systems to improve accuracy and reduce processing costs, there remains the issue of what to do with the inaccurate data already in the existing system. According to DFAS officials, while the transferred data will be tested for logic errors, such as missing contract numbers, verification for accuracy would require contract reconciliation. They said limited resources restrict the number of reconciliations they can complete. According to DOD, it has not yet made a decision on how to avoid transferring erroneous data to the new system, but it believes that other initiatives may help minimize errors.

The current system also contains contracts that DFAS considers unreconcilable because of missing documents. In March 1996, DFAS proposed that DCMC negotiate settlements with contractors for 57 unreconcilable contracts, permitting DOD to close these contracts. In October 1996, DCMC directed its administrative contracting officers to settle these contracts within 180 days. DOD now needs to decide what to do with all the other unreconcilable contracts. It needs to establish an overall policy for closing out existing contracts that cannot be reconciled because of incomplete data. That policy should take into account such factors as the age and complexity of the contract, the dollar value of the discrepancy, and the possibility of multiple errors.

DOD's initiatives do not fully streamline the contract payment process. DFAS still matches multiple documents before making a payment. However, there may be appropriate opportunities to eliminate the requirement to match payments to invoices, such as when the existence of a receiving report constitutes sufficient evidence that a payment is owed. This

practice is consistent with our guidance to federal agencies.¹³ Commercial best practices provide some lessons on how this might be done while maintaining adequate controls (see p. 26).

Alternate procurement practices for small purchases, such as use of the purchase card, are not being fully used. As shown in table 2, 21 percent of the DCMC-administered contracts had a value of \$2,500 or less.

Table 2: Contract Value Per Contract

Contract values	Number of contracts	Cumulative percent
\$0	452	0
\$1 to \$100	3,265	2
\$101 to \$2,500	41,836	21
\$2,501 to \$10,000	40,408	40
\$10,001 to \$100,000	68,481	71
\$100,001 to \$1,000,000	42,753	91
more than \$1,000,000	19,713	100
Total	216,908	

Source: GAO analysis of "active" contracts from the MOCAS system, March-April 1996.

Contracts of \$2,500 or less are within the current threshold for micropurchases and could be paid using the government purchase card.¹⁴ While DOD is expanding its use of purchase cards, table 2 suggests that there are even more opportunities to streamline the process, through increased use of purchase cards or other means.

DOD recognizes that it is costly to account for payments at the ACRN level and that, in some instances, the information obtained may be inaccurate and of questionable value. While DOD is continuing to review how best to improve the process, DOD officials believe that the information collected is necessary to comply with the Anti-Deficiency Act and other management requirements.

We recognize the importance of compliance with the Anti-Deficiency Act; however, we do not believe that DOD's current detail level of accounting is required to achieve this compliance. Our analysis indicates that DOD's

¹³GAO Policy and Procedures Manual for the Guidance of Federal Agencies, Title 7, "Fiscal Procedures."

¹⁴Micropurchases are exempt from the Buy America Act, certain small business requirements, and the general requirement for competition.

current detail level of accounting is driven by internal management decisions regarding the allotment of appropriations and not the Anti-Deficiency Act or any other regulations prescribed under this act. We agree that once these allotments are made, the requirements of the Anti-Deficiency Act are imposed. DOD's current accounting detail goes beyond the requirements of this act because appropriations are allocated and suballocated. In some instances, this level of fund distribution may be desired for internal management purposes. However, current DOD initiatives are moving away from the detail levels and toward a higher level of fund distribution and obligation accounting. For example, as mentioned earlier, NAVAIR has a policy prohibiting the suballocation of funds to other NAVAIR organizational units within the same program office, thereby limiting the accounting detail and reducing the number of unique contract ACRNS.

Conclusions and Recommendations

It is imperative that DOD achieve cost-effective control over its payment process. Otherwise, it continues to risk hundreds of millions of dollars in potential overpayments and other financial management and accounting control problems. Further, improving the efficiency of the payment process could save additional millions of dollars annually in reduced processing costs. Improving DOD's payment system will not be an easy or quick undertaking. It will require continued top management attention and support for many years to come.

DOD is moving in the right direction in attempting to strengthen its use of automated systems, ensure that these systems are integrated, and adopt best practices. However, when and to what degree these actions will correct its problems remains to be seen. Further, additional steps can be taken to ensure that the payment problems are effectively and efficiently addressed, including increased use of purchase cards for small purchases and reduction in the requirement to match payments to invoices if other controls are in place. DOD might also benefit from further examining best practices of organizations that have reengineered their contract payments process.

We recommend that the Secretary of Defense direct the DOD Comptroller and the Under Secretary of Defense for Acquisition and Technology, as a part of their improvement strategy, to:

- thoroughly evaluate the information requirements of the user, procurement, and accounting communities in terms of their impact on the

payment process and on the process' ability to produce useful information, in order to reduce the amount of detail accounting placed on the payment center;

- evaluate whether the pricing structure that the Columbus Center uses to charge its customers for accounting services needs to better reflect the cost of servicing contracts, particularly where the customer requires costly detailed expenditure information;
- establish a DOD-wide policy for closing out existing contracts that cannot be reconciled because accurate and complete data are lacking. Such a policy should take into account such factors as the age and complexity of the contract, the dollar value of the discrepancy, and the possibility of multiple errors; and
- explore increased opportunities for using best practices, including streamlined payment techniques, such as purchase cards. Twenty-one percent of DCMC-administered contracts paid by the Columbus Center were \$2,500 or less. In addition, consider eliminating the requirement to match payments to invoices, where appropriate, such as when the existence of a receiving report may constitute sufficient evidence that a payment is owed.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD said that the report (1) does not address some of the major factors contributing to the complexity of the contract payment process, (2) over simplifies the applicability and implementation of best practices, and (3) does not present the full scope of DOD's aggressive improvement initiatives. DOD also indicated that most of the recommended actions were underway within the Department. However, none had been completed. DOD has a long way to go before its payment problems are under control.

We recognize that there may well be other factors contributing to DOD's payment problems, including the complexity of contracting requirements for major weapon systems. However, our review indicated that effectively addressing the factors highlighted in this report is key to DOD's ability to correct the payment problems we identified in this and in previous reports.

We also recognize that DOD is aware of the seriousness of its payment problems and is taking steps to address them. The draft report discussed a number of DOD initiatives to address its payment problems, but based on DOD's comments, we have included an additional DOD initiative in the final report.

We acknowledge in the report that DOD is exploring the use of some best practices. During our review, we attempted to identify other best practices that might be worth further examination by DOD. The scope of our review did not include a detail examination of each best practice and the feasibility of its adoption, or the legislative and regulatory changes that might be required before implementing these practices. We believe, nevertheless, that there may be additional opportunities for DOD to take advantage of best practices and we present information on companies that have reengineered their payment practices to illustrate the types of initiatives they undertook. As DOD examines these best practices, it will need to examine the legislative or regulatory impacts of their adoption. In this regard, in other work we have underway, we found that DOD lacks the information necessary to analyze the costs and benefits of legislative initiatives it believes would streamline its payment processes.

DOD's comments refer to five recommendations. We have consolidated them into four recommendations in the final report. DOD's comments are presented in their entirety in appendix II, along with our more detailed evaluation of them.

Scope and Methodology

To determine the factors contributing to payment process errors and cost, and DOD's efforts to improve its payment process, we interviewed officials and reviewed supporting documentation from the

- Office of the Under Secretary of Defense Comptroller/Chief Financial Officer, Office of the Principal Deputy Under Secretary of Defense for Acquisition and Technology, Deputy Under Secretary of Defense for Acquisition Reform, Washington, D.C.;
- Defense Finance and Accounting Service Headquarters, Navy Finance and Accounting Office, Office of the Assistant Secretary of Defense Command, Control, Communications, and Computer Systems Directorate, Department of the Navy's Office of Research Development and Acquisition, Arlington, Virginia;
- Army Materiel Command, Alexandria, Virginia;
- Defense Logistics Agency, Fort Belvoir, Virginia;
- Air Force Materiel Command, Dayton, Ohio;
- Army Aviation and Troop Command, Defense Finance and Accounting Service, St. Louis, Missouri; and
- Defense Finance and Accounting Service, Columbus Center, Columbus, Ohio.

We also obtained information from Coopers & Lybrand LLP and KPMG Peat Marwick, LLP firms DOD engaged to assist in resolving its contract payment problems.

To determine the characteristics of DCMC-administered contracts paid by the Columbus Center, we obtained contract and payment data from the MOCAS system the Center used to pay contracts. We analyzed those contracts classified as "both physically and administratively active, and have line items left to be shipped." We did not statistically verify the accuracy of the data.

To identify best commercial practices that DOD might adopt to further enhance its payment process, we reviewed articles, books, and on-line databases on reengineering; identified organizations that were highlighted as developing and implementing innovative management practices; and visited the following organizations:

- Electronic Data Systems, Plano, Texas;
- the Boeing Company, Seattle, Washington;
- ITT Automotive, Auburn Hills, Michigan; and
- University of California, Berkeley, California.

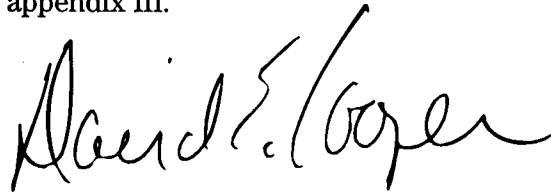
At each organization, we discussed and obtained documentation related to the organization's reengineering efforts associated with contract payments.

We also obtained information from an accounts payable reengineering conference and workshop, which included case studies from various companies and consulting firms. However, we did not independently verify cost data obtained from DOD or the organizations we visited.

We conducted our review between December 1995 and October 1996 in accordance with generally accepted government auditing standards.

As agreed with your offices, we plan no further distribution of this report until 30 days from its issue date unless you publicly announce its contents earlier. At that time, we will send copies to the Secretary of Defense; the Director, Office of Management and Budget; and other interested congressional committees. We will also make copies available to others upon request.

Please contact me at (202) 512-4587 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix III.

A handwritten signature in black ink, reading "David E. Cooper". The signature is fluid and cursive, with the first name "David" being the most prominent.

David E. Cooper
Associate Director
Defense Acquisitions Issues

Contents

Letter	1
Appendix I Best Practices of Four Nonfederal Organizations	24
Appendix II Comments From the Department of Defense	29
Appendix III Major Contributors to This Report	40
Related GAO Products	43
Tables	
Table 1: Number of ACRNs Per Contract	10
Table 2: Contract Value Per Contract	16
Figures	
Figure 1: Activity Cost Analysis by Contract Payment Function	4
Figure 2: Payment Process Information Flow	6
Figure 3: Example of DOD's Long Line of Accounting	9
Figure 4: Contract Excerpt	11
Figure I.1: Commercial Two-Way Match and DOD's Five-Way Match	27

Abbreviations

ACRN	accounting classification reference number
DCMC	Defense Contract Management Command
DFAS	Defense Finance and Accounting Service
DOD	Department of Defense
EDI	electronic data interchange
FTE	full-time employee equivalent
MOCAS	Mechanization of Contract Administrative Services
NAVAIR	Naval Air Systems Command

Best Practices of Four Nonfederal Organizations

The nonfederal organizations we visited—Boeing, Electronic Data Systems, ITT Automotive, and the University of California at Berkeley—reported significant improvement in efficiencies while reducing administrative costs of paying invoices by implementing best practices. These organizations undertook a fundamental reassessment of the costs and benefits of process controls, known as risk management. They focused on a long-term effort of continual improvements with contract payments viewed as an integral part of the acquisition process. In general, these organizations combined technological improvements with streamlined processes to improve service and reduce costs.

Risk Management

Organization officials said that one key to successful reengineering was a fundamental reevaluation of the nature and extent of controls required in their organizations. Competition demands for cost and cycle time reductions forced these organizations to assess whether the cost of controls exceeded the potential risk for exposure. According to these officials, making this assessment allowed the organizations to eliminate non-value added activities and streamline their processes.

At a reengineering accounts payable conference, a consulting firm pointed out that reducing organization controls meant that senior management had to ensure a culture of high integrity and values. At the same time, compliance should be verified by sampling transactions and reviewing exception-based information. For example, in establishing its purchase card program, one organization made it clear that with a simplified procurement process came responsibility and accountability. The organization indicated that if a random audit revealed an employee misused the card, the organization might suspend the employee's card and fire the employee.

Organizational Improvement

Two of the organizational changes undertaken involved (1) consolidating the accounting activities and (2) managing contract payments as part of the overall acquisition process. Officials from two organizations we visited said that their companies consolidated the accounting activities, including the payment function, into one central location to reduce overhead and improve efficiencies. Before reengineering, these organizations were decentralized, with each business unit operating autonomously and generally using different processes and systems.

The notion that procurement and payment were part of the overall, interrelated, acquisition process was a difficult concept to get people to appreciate, according to organization officials. They explained that these activities are traditionally separate, autonomous functions, and are often at odds with one another. As with the Department of Defense (DOD), complexity of contracts and incomplete or erroneous data provided by procurement personnel frustrated the organization's ability to pay contracts accurately and efficiently. Officials pointed out that successful reengineering of the contract payment function required cooperation from procurement personnel. It also required support from a level of management higher than the accounting and procurement functions to ensure cooperation.

Solutions cited by the organizations we visited included educating procurement and payment personnel about each other's processes and requirements, and showing the financial impact of not meeting those requirements. In addition, one organization had payment personnel involved during negotiations for complex contracts. According to this company official, early involvement helped ensure simpler payment terms or at least familiarity with the reasons behind payment terms and made paying the contract easier.

Technological Improvements

Another objective of the reengineering was to have a seamless, fully integrated system that allowed on-line access. This required some organizations to replace their multiple software systems with one system that integrated the procurement, payment, and accounting functions. The organizations opted to either buy commercial software packages or better use in-house systems already developed. One official told us that by selecting commercial software, his organization decided to collect less information in some cases than it had done previously. This reduced the costs of modifying and maintaining the software.

Besides having integrated software, organizations also used electronic data interchange (EDI), which allows the electronic exchange of business information, including payment information, in a standardized format, and electronic funds transfer.

After implementing these changes, the organizations reported labor-saving improvements. These included: (1) reduced data entry, which increased accuracy and timeliness of invoice and document processing and (2) reduced administrative costs through elimination of special handling,

distribution, research, and follow-up due to errors. Less quantifiable benefits included enhanced financial management information. One organization projected net savings of \$1.8 million a year from its integrated systems.

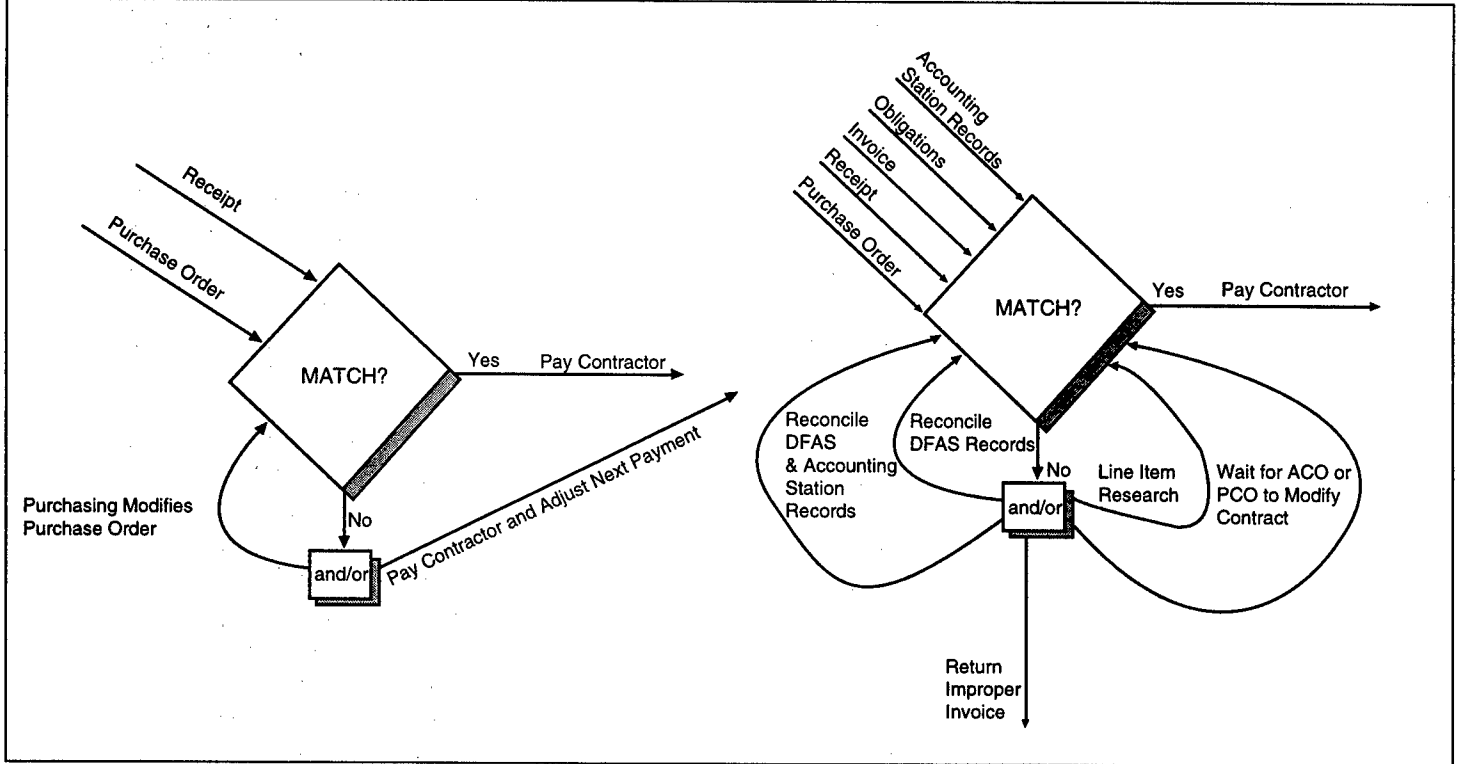
Streamlined Payment Processes

Organizations we visited streamlined their processes by implementing (1) a two-way matching process and (2) alternate procurement methods, specifically purchase cards, for smaller purchases. The organizations did not have data on how much these two practices had saved. A management consultant said, however, that companies using these practices typically achieve a savings equaling 40 percent of processing costs.

A two-way match of documents eliminates one document used to make a payment. Previously, approval to pay a vendor required matching data on three documents—the purchase order, the invoice and the receiving document. If there was a discrepancy in any of the three documents, payment personnel had to research the discrepancy through correspondence and telephone calls with the vendor and purchaser. Unlike the federal government, which is required to match payments to obligations, the visited organizations do not match payments to budget before paying an invoice. However, they post payments to cost accounts, which management may use in budget-to-actual comparisons.

Three of the organizations we visited eliminated one of the three documents for matching before payment. The organizations reported that matching two documents greatly reduced reconciliation problems, yet still maintained payment controls. These organizations employ an “evaluated receipts” or “pay-on-receipt” process that uses the purchase order and the receiving document for terms, price, and quantity. The system automatically calculates payment. The process requires (1) having integrated systems, (2) cooperation from vendors who may have to modify their billing and shipping documents and practices, and (3) cooperation from those receiving the goods or services. Figure I.1 shows both the two-way matching process and DOD’s matching process, which was discussed on page 6.

Figure I.1: Commercial Two-Way Match and DOD's Five-Way Match



Source: GAO.

Three organizations we visited also increased the use of purchase cards. Two of these organizations adopted the use of the cards after they found that small purchases accounted for a small percentage of purchase dollars, but represented a large percentage of the transactions. For example, one organization determined that before reengineering, total acquisition costs (including those for procurement and payment) averaged about \$142, but at least 20 percent of its invoices were for purchases of less than \$100. By issuing purchase cards to the individuals who were likely to make small purchases, the organization eliminated the need to prepare and approve requisitions and purchase orders. In addition, the purchase card reduced the number of payment transactions. The organization reported eliminating about 5,000 payment transactions a month by making 1 electronic payment to the card issuer.

Controls were maintained by setting guidelines, limiting the purchase amount per transaction and per month, and periodic reviews of charges. Officials noted that each card can be coded so that purchases are charged to the proper cost accounts. One organization official said that accounting requirements were less detailed than previously. However, he believed the increased efficiency of management reviews of consolidated information and savings per transaction outweighed the usefulness of the more detailed accounting information.

Our report on federal agencies' use of purchase cards also showed that agencies were able to reduce labor and payment processing costs by using purchase cards for simple purchases.¹

Reduced Cost and Improved Productivity

Two of the private-sector organizations we visited had available processing costs. They reported that reengineering reduced their direct labor costs to process a contract payment to less than \$3—a 30- to 50-percent reduction. A study of 700 firms conducted by a management consulting firm showed labor costs for invoice processing ranged from \$0.71 to \$12.23 per invoice.

Moreover, the organizations we visited reported that payment productivity increased. For example, one organization reported that the annual number of invoices processed per full-time employee equivalent (FTE) nearly doubled from about 8,500 to 16,400, a 93-percent increase. The consulting firm also reported that the number of invoices processed per FTE ranged from about 1,900 to about 55,000 per year with an average of about 11,000 per year. The Columbus Center processes an average of about 1,000 invoices per individual per year.²

¹Acquisition Reform: Purchase Card Use Cuts Procurement Costs, Improves Efficiency (GAO/NSIAD-96-138, Aug. 6, 1996).

²Based on about 1.2 million invoices paid divided by the total payment personnel in the Center's disbursing section and three payment directorates. FTE data was not available.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMPTROLLER

Mr. David E. Cooper
Associate Director
Defense Acquisitions Issues
National Security and
International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



FEB 7 1997

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DoD PROCUREMENT: DoD Can Enhance Its Contract Payment Initiatives," dated December 18, 1996 (GAO Code 705124/OSD Case 1268).

In general, the Department believes that the draft report represents a high level summary of a number of issues that contribute to the complexity of the contract payment process. However, the draft report completely ignores major factors contributing to the complexity of large contracts and the impacts those factors have on the payment process. Also, the draft report does not accurately portray the scope of the initiatives the Department has in progress to improve contract payment processing within the DoD. In addition, the draft report oversimplifies the applicability of the cited private sector best practices such as the purchase card. Further, the draft report does not address the legislative and regulatory changes that would be required before the Department could implement the cited best practices. Finally, four of the five recommended actions already are underway within the Department; however, the draft report fails to acknowledge that the actions recommended in the draft report already were being implemented by the Department.

The Department believes that, as currently written, the draft report will mislead its readers in three ways. First, it does not address some of the major factors influencing the contract payment process. Second, the draft report over simplifies the applicability and implementation of the cited best practices. Third and most important, the draft report does not represent fairly the Department's aggressive improvement initiatives, aimed at correcting previously acknowledged contract payment problems. The two enclosures provide the Department's detailed comments.

The Department appreciates the opportunity to comment on the draft report.

Sincerely,


Alvin Tucker
Deputy Chief Financial Officer

Enclosures

See comment 1.

Appendix II
Comments From the Department of Defense

GENERAL ACCOUNTING OFFICE DRAFT REPORT DATED DECEMBER 18, 1996,
GAO CODE 705124, OSD CASE 1268

**"DOD PROCUREMENT: DOD CAN ENHANCE ITS CONTRACT PAYMENT
INITIATIVES"**

DETAILED DOD COMMENTS ON THE DRAFT REPORT

GENERAL COMMENTS:

The report begins by identifying several factors that significantly contribute to errors in the DoD's payment process. These are identified in the report as factors: (1) nonintegrated computer systems; (2) requirements to match multiple documents; and (3) requirements to allocate payments among numerous accounting categories. While these factors do contribute to payment errors there are other equally significant factors (addressed below) that the GAO did not address in the draft report. In addition, the report does not explain the initiatives that the Department already has underway both to reengineer processes and eliminate manual data entry.

Many of the Department's weapons systems contracts involve very complex sets of functional requirements. These functional complexities create complex procurements that in turn result in complex payment requests. During the course of the GAO review the factors addressed below were identified to the GAO. However, the GAO did not address these factors in its report. As a result, the summary level report prepared by the GAO may lead the reader to an incomplete or inaccurate understanding of the subject.

- Contracts for the design, production and support of weapons systems--such as, ships, aircraft or tanks--often are funded by the Congress under multiple appropriations, and over multiple fiscal years. Each of these funds must be accounted for, obligated, and disbursed separately--in effect treated as separate bank accounts--even though the amounts all fund the same contract. This may be analogous to several companies jointly funding a contract.
- Major contracts easily can have hundreds of separately priced items or services.
- It is the norm for major contracts to be modified many times over the life of the contract.
- Weapons systems contracts may contain differing pricing provisions, with some individual items or services being fixed price and others provided on a cost reimbursable basis.

The draft report discusses private sector practices but does not address whether or how those practices are applicable to the federal government. The draft report does not discuss the legislative, or regulatory changes that may be required to implement such practices. The draft report also does not place the private sector practices in context by informing the reader of the dollar/action volume of vendor payments by the companies visited, and the complexity of the vendor requirements. The draft report does not adequately address the extent of the Department's actions to reengineer its operations and adopt best practices.

Discussed on pp. 18-19.

Discussed on p. 19.

Appendix II
Comments From the Department of Defense

The draft report does not place its own work in context. Notwithstanding the focus on DFAS-Columbus Center, the report does not place that Center's workload in the context of total DoD contract payments. For example, it does not inform the reader that the majority of contract payments occur outside the Mechanization of Contract Administration Services (MOCAS) system used by the Defense Finance and Accounting Service (DFAS)-Columbus Center and are, therefore, outside the scope and focus of this report. Nor does the report identify that while the payments made by the DFAS-Columbus Center using MOCAS amount to 42 percent of dollars paid by the DoD to contractors and vendors, the DFAS-Columbus Center's MOCAS systems pays only 5 percent of the contractor/vendor invoices paid by DoD.

The draft report states, "We (GAO) are not convinced that the law requires the degree of detailed accounting and contract reconciliation currently practiced by DoD." However, the report fails to provide any legal or regulatory basis for this statement. The report should identify the criteria that the GAO used to reach such a conclusion, and identify the level of accounting that the GAO believes is required. As written, the reader of this report is led to believe that the Department is engaged in unnecessary work. However, the GAO provides no objective analysis of the level of accounting required.

Actions to implement four (1, 3, 4 and 5) of the five recommendations cited in the report already are in place, with joint task teams working to determine and execute their usage. However, there is no recognition of these actions by the GAO. Instead, the reader is led to believe that the GAO identified the need for the DoD to start such efforts.

SPECIFIC COMMENTS: The following comments are keyed to specific references in the draft report.

The report states DoD will continue with these problems as DoD converts to the new systems, by transferring existing erroneous data into these systems. Such a statement is presumptuous, as it assumes a particular strategy prior to a strategy decision having been made. It also assumes that DoD is not intelligent enough to figure out that if DoD transfers the existing data base to a new system without reviewing the data base that existing errors also will be transferred to the new systems. The Department usually does review its data bases for accuracy before placing the data into a new system. (Page 3, last paragraph, second sentence)

The requirement to match multiple documents does not itself contribute to the number of errors in the process. It may, however, add to the cost. (Page 7, first paragraph, second bullet)

The electronic transmissions referred to are the old Military Standard Contract Administration Procedures (MILSCAP) transmissions. As cited, the statement is true of MILSCAP transmissions; however, the report does not mention that several of the major procurement offices do not have the capability to generate the MILSCAP transactions. More importantly, the Department made the decision in 1995 to implement the government and industry standard ANSI X-12 contract transaction sets as the means of eliminating the manual data entry of contract data into its accounting and payment systems. This is not recognized in the draft report. (Page 9, first full sentence)

Appendix II
Comments From the Department of Defense

The defined matching process indicates that the DFAS-Columbus Center employees match multiple documents for all payments. It is more accurate to say that the payment process in the MOCAS system involves the matching of two or three records depending on the type of payment. In the case of financing payments, there is a two way match--the payment request record is matched to the contract record. In the case of delivery payments, there is a three way match--the delivery record, the invoice record, and the contract record are matched. Receipt information normally is entered into the system by the contract administration office. These matches are performed by automated programs unless the contract is coded for manual payment. Only when mismatches occur are employees required to research the issue. (Page 10)

It is not the norm to spend 5 years reconciling a single contract. This example represents a worse case scenario. This should be clarified. (Page 12, second paragraph, fourth sentence)

This sentence seems to be out of context in its present position as part of the cited example. The sentence addresses the cost of all of the reconciliation(s) performed by the contractor during one fiscal year, not just costs for the cited example. This should be clarified. (Page 12, second paragraph, last sentence)

It would be helpful to the reader if the section on accounting lines clearly identified these as representing detailed obligation transactions. The major underlying issues here are cost accounting requirements versus obligational accounting requirements and what is needed for cost reports to be considered reliable. Traditionally, cost reports have not been considered reliable unless the figures can be traced directly back to individually identified obligations and disbursements. As a result, each requirement for cost identification results in a need for further breakout of the available funds as separate obligations. Those obligations become individual accounting lines on contracts, and this results in increased complexity because payments must be processed against individual accounting lines. While the Department is working to identify areas where the numbers of accounting lines on contracts can be reduced, existing statutory and regulatory requirements will continue to require that contracts be funded with multiple accounting lines. (Page 13)

A payment with many accounting classification reference numbers (ACRNs) does not normally take six to eight hours to process. There are very few payments at the Columbus Center in a given year that require this length of time to process. The time required to process the payment primarily is due to filling out the posting slip. The DFAS is implementing the Entitlement Automation System (EAS) that will eliminate a substantial portion of the manual effort in these cases. The GAO comment should be clarified. (Page 15)

The discussion of the proration of ACRNs on progress payments while factual, does not provide sufficient information for the reader to fully understand the issues involved. Nor does it propose a course of action. Since progress payment processing is the subject of a separate ongoing GAO review, it may be better to acknowledge that there are several issues involved and explain that progress payment processing is the subject of a separate GAO review. (Pages 18 and 19)

Appendix II
Comments From the Department of Defense

The Department is moving aggressively to expand the use of the International Merchant Purchase Authorization Card (IMPAC) purchase card, and in fact is well ahead of the rest of the federal agencies in the number of transactions being processed. Over 84,000 cards have been issued within DoD as of the end of December 1996. During the first quarter of FY 1997, the DoD used the IMPAC card to make 935,750 purchases valued at \$410 million. This information should be included to better permit the reader to understand that the DoD is doing more than just "formed two teams to recommend" actions. (Page 31, second paragraph, third sentence)

The report states that, in 1994, the Defense Commissary Agency (DeCA) eliminated the need for an invoice and is reporting a 40 percent reduction in the number of payment personnel. While the DeCA did eliminate the need for separate invoices for certain purchases, the requirement for the information contained on the invoice was not eliminated. Instead, applicable invoices were eliminated by requiring vendors to place additional information on the delivery ticket--in effect replacing a separate invoice through the use of delivery ticket invoicing. Also, the report implies that the cited 40 percent reduction in payment personnel supporting the payment of DeCA invoices is solely the result of the use of delivery ticket invoicing. While the a significant portion of the savings are attributable to the use of delivery ticket invoicing--vice separate invoices, implementation of standard contracting procedures, and associated systems enhancements, also played a significant role in achieving the 40 percent savings. Thus, it is misleading to attribute the cited 40 percent reduction entirely to changing from separate invoices to delivery ticket invoicing. (Page 32, first paragraph, last sentence)

The report states DoD will continue with these problems as DoD converts to the new systems by transferring existing erroneous data into these systems. Such a statement is presumptuous, as it assumes a particular strategy prior to a strategy decision having been made. It also assumes that DoD is not intelligent enough to figure out that, if DoD transfers the existing data base to a new system without reviewing the data base, then existing errors also will be transferred to the new systems. The Department usually does review its data bases for accuracy before placing the data into a new system. (Page 32, last paragraph, second sentence)

The Department is prioritizing its reconciliation efforts and is not spending thousands of dollars to resolve very small discrepancies. The comment was made in the context of risk management as practiced by the private sector versus the Federal payment statutes that reflect zero tolerance of fraud, waste or abuse with respect to payments of public funds. This should be clarified. (Page 34, last paragraph, last sentence)

Appendix II
Comments From the Department of Defense

GENERAL ACCOUNTING OFFICE DRAFT REPORT DATED DECEMBER 18, 1996,
GAO CODE 705124, OSD CASE 1268

**"DOD PROCUREMENT: DOD CAN ENHANCE ITS CONTRACT PAYMENT
INITIATIVES"**

DOD COMMENTS ON THE RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology), working as an integrated team, develop a strategy to ensure that the requirements of the user, procurement, and accounting communities are thoroughly evaluated in designing solutions to payment problems. DoD's concept of Integrated Process Teams appears well suited for this purpose.

DoD RESPONSE: The Department does not believe that the recommendation is necessary because the Under Secretaries already are, and have been for several years, working closely together in addressing payment problems. This integrated approach extends from the Under Secretaries through all levels of their staffs to individual workers in the field. Examples include: the Acquisition and Financial Management Panel, led by the Under Secretary of Defense (Comptroller) and the Principal Deputy Under Secretary of Defense (Acquisition and Technology); the DoD Contract Finance Committee, composed of procurement and comptroller specialists from DoD Components and civilian agencies; and special reconciliation groups lead by Defense Contract Management Command (DCMC) Administrative Contracting Officers, to address specific, difficult-to-reconcile contracts. This close interaction has applied to design of new procurement and payment systems, as well as improvements in existing contract writing and payment systems specifically targeted to reduce payment problems. Recommending that the Department take a specific action implies that the Department is not engaged already in the desired activity. Therefore the Department does not believe that this recommendation is warranted.

RECOMMENDATION 2: The GAO recommended that the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology), working as an integrated team, develop a strategy to ensure that the pricing structure that the Columbus Center uses to charge its customers for accounting services considers the cost of servicing contracts where the customer requires costly detailed expenditure information.

DoD RESPONSE: Partially concur. The Defense Finance and Accounting Service (DFAS) will review the feasibility of revising its pricing structure for invoice processing. However, it must be recognized that the extra detail and complexity of a variable rate internal billing system has three major sets of additional costs: (1) creating such a system diverts scarce resources from the task of designing and building more functional procurement and payment systems, (2) it will increase the cost and complexity of the systems themselves, and (3) it increases the overall costs of performing the procurement and payment functions.

See comment 11.

See comment 12.

Appendix II
Comments From the Department of Defense

Now recommendation 4.

RECOMMENDATION 3: The GAO recommended that the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology), working as an integrated team, develop a strategy to ensure that maximum use is made of streamlined payment techniques, such as purchase cards. (Currently, 20 percent of DCMC contracts paid by the Columbus Center are \$2,500 or less.)

See comment 13.

DoD RESPONSE: The Department believes that this recommendation is unnecessary because the Department already has, and is continuing to, increase the use of the government purchase card (IMPAC) where it is proper and cost effective. Further, the recommendation over simplifies the use of the IMPAC card. With the IMPAC card the cardholder is responsible for placing the order and validating receipt of the goods and reconciling the monthly billing statement. This process works well when the goods are shipped to, or picked-up by, the ordering office, and all of the purchases made with a card are chargeable to a single line of accounting. In the case of many of the items paid by the DFAS-Columbus Center using the Mechanization of Contract Administration Services (MOCAS) system, the items require source inspection or acceptance functions that are performed by offices other than the ordering office. Offices of the DCMC typically perform the inspection and acceptance functions that take place at contractor's plants. In addition, the orders for these repair parts may have been generated by an inventory management system based on predetermined reorder levels. The Department is attempting to make maximum use of the purchase card where use of the card makes good business sense. However, many of the contracts administered at the DFAS-Columbus Center do not lend themselves to the cost effective use of the IMPAC program.

In some cases, other approaches such as Electronic Commerce/Electronic Data Interchange (EC/EDI) may represent a more cost-effective solution. The DFAS-Columbus Center has been contacting contractors and encouraging them to submit their invoices electronically using the standard EC/EDI transaction sets.

Now recommendation 3.

RECOMMENDATION 4: The GAO recommended that the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology), working as an integrated team, develop a strategy to ensure that a policy is established for closing out existing contracts that cannot be reconciled because accurate and complete data are lacking. Such a policy should take into account such factors as the age and complexity of the contract, the dollar value of the discrepancy, and the possibility of multiple errors.

See comment 14.

DoD RESPONSE: The Department does not believe that there is a need for the recommendation. A process already exists to close out contracts where the reconciliations cannot be completed due to missing or incomplete documentation. One example of the use of these procedures is found in the Defense Management Command memorandum of October 25, 1996, the subject of which is Negotiated Reconciliation Process. This memorandum directs the DCMC Administrative Contracting Officers to chair special reconciliation teams for such contracts. The teams assemble missing documents from all possible sources, and assist the accounting officer, the disbursing officer, and where necessary, the contractor, in reconciling discrepancies, and determining the correct balances for the contracts.

Appendix II
Comments From the Department of Defense

Now recommendation 4.

RECOMMENDATION 5: We (GAO) recommended that the Under Secretary of Defense (Comptroller) and the Under Secretary of Defense (Acquisition and Technology), working as an integrated team, develop a strategy to ensure that consideration be given to eliminating the requirement to match payments to invoices, where appropriate, such as when the existence of a receiving report may constitute sufficient evidence that a payment is owed.

DoD RESPONSE: The Department does not believe that there is a need for the recommendation. The DoD already has started to eliminate the requirement for the invoice as a separate document for many contracts. However, it must be noted that an important distinction needs to be made between eliminating the invoice, and eliminating a separate invoice document. This difference is not semantic. Only if the Criminal and Civil Divisions of the Department of Justice agrees that civil and criminal actions under the False Claims Act will not be impaired, can the requirement for the contractor to request payment be removed from most supply and service contracts. On the other hand, functionally, the difference between the data in an invoice document and in shipping/receiving document is very small (as little as one data field for "invoice number"). A pilot initiative at the Defense Commissary Agency using the "Delivery Ticket as Invoice" has been in place for some time (The delivery ticket is adjusted to include the invoice data). At the request of DFAS, the DoD Contract Finance Committee is drafting clauses to extend the concept to MOCAS paid contracts using the DD Form 250 (or electronic equivalent).

See comment 15.

Here again other options may produce more advantageous streamlining of the payment process. For example, the DFAS Denver and Indianapolis Centers are testing a micro purchase (less than \$2,500) payment process that provides for payment of invoices without matching the receiving report. A statistical sampling process will be used, after payment is made, to verify that the billed items have been received. These tests are based on past experience of very low discrepancy rates between invoices and receipts.

The following are GAO's comments on the Department of Defense's letter dated February 7, 1997.

GAO Comments

1. DOD's principal concerns are discussed and evaluated on pages 17 and 18 of this report.
2. We have modified the report to reflect the percent of dollars and the percent of invoices paid by the Defense Finance and Accounting Service (DFAS) Columbus.
3. We have added language to clarify our position and provided a more detailed discussion of the basis for our conclusion, which is presented on pages 15-16.
4. We have added additional information on DOD's initiatives and have modified our recommendations so as to not imply that the DOD Comptroller and the Under Secretary of Defense for Acquisition and Technology are not working together. Our observations on DOD's comments related to specific recommendations are discussed below.
5. We have modified the report based on this comment.
6. The report mentions that one of DOD's initiatives to eliminate manual data entry is the use of EDI, including ANSI X-12. DFAS currently has limited testing underway for EDI transactions. However, as we mentioned on page 6, manual entry will be required in certain situations.
7. The report explains "matching" in much the same way as DOD's comment. However, DOD's comment does not discuss the procedures followed by the Center to verify obligations in its accounting records, or the prevalidation with the accounting station's records. As we pointed out in the report, efforts to resolve mismatches through invoice research, contract reconciliation, and manual processing account for about 57 percent of average payment costs (p. 4). About one-third of the Center's contract payment personnel are dedicated to invoice research and contract reconciliation.
8. Our report mentions that this amount is for "reconciliation support on numerous contracts," not just the one discussed in the paragraph.

9. We have added language to clarify our position and provided the basis for our conclusion.

10. The 6-8 hours refers to one case we reviewed. The Columbus Center was unable to provide us with overall data on the time required to process a payment. We modified the report to include the Entitlement Automation System as one of DOD's initiatives.

11. We have modified the report based on DOD's comments, but we continue to believe that it may be not only possible, but desirable to look for ways to reduce the amount of detailed information going through the payment center.

12. The purpose of this recommendation is to place on those organizations that request excessively detail payment accounting the costs associated with these payment requirements. This action might incentivize these organizations to look more carefully at the demands they place on the payment system. To the extent the Department finds that the costs associated with implementing this recommendation exceeds its benefits, we would defer to DOD's judgment in this regard. We are pleased that DOD has agreed to study the recommendation's feasibility.

13. Although the Department is increasing its use of government purchase cards, our analysis of DFAS payments show that 21 percent of the Defense Contract Management Command (DCMC)-administered contracts paid by DFAS, Columbus, has a value of \$2,500 or less (p. 15). This suggests to us that there may be further opportunities to streamline the process, through increased use of purchase cards or other means. We have modified the recommendation to indicate that there may be other means, other than purchase cards, to streamline the payment of small purchases.

14. The cited memorandum, dated October 25, 1996, is applicable to 57 specific contracts and does not represent a DOD-wide policy for closing out contracts. DFAS-Columbus officials told us the Center has no general guidance to handle unreconcilable contracts.

15. As we pointed out in our draft, vendors may have to modify their shipping/receiving documents to conform with invoicing requirements. Our draft also noted that elimination of the invoice is consistent with our guidance for federal agencies, GAO Policy and Procedures Manual for the Guidance of Federal Agencies, Title 7, "Fiscal Procedures." At the same

time, we recognize that the False Claims Act may require some alternative evidence of a contractor request for payment.

The draft includes a discussion of the DFAS Denver pilot. The Denver pilot still requires three documents—the purchase order, the invoice, and a statistical sample of the shipping/receiving documents; whereas the evaluated receipts method requires two—the purchase order and receiving document—and allows for 100-percent verification of receipt of goods.

Major Contributors to This Report

National Security and
International Affairs
Division, Washington,
D.C.

Charles Thompson
David Childress

Office of General
Counsel

Margaret Armen

Dallas Field Office

Hilary Sullivan
Jeffrey Knott
Jack Kriethe
Kay Muse
Joe Quicksall
James Turkett

Related GAO Products

Financial Management: DOD Needs to Lower the Disbursement Prevalidation Threshold (GAO/AIMD-96-82, June 11, 1996).

DOD Infrastructure: DOD Is Opening Unneeded Finance and Accounting Offices (GAO/NSIAD-96-113, Apr. 16, 1996).

Defense Infrastructure: Budget Estimates for 1996-2001 Offer Little Savings for Modernization (GAO/NSIAD-96-131, Apr. 4, 1996).

DOD Procurement: Millions in Contract Payment Errors Not Detected and Resolved Promptly (GAO/NSIAD-96-8, Oct. 6, 1995).

DOD Infrastructure: DOD's Planned Finance and Accounting Structure Is Not Well Justified (GAO/NSIAD-95-127, Sept. 18, 1995).

Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-146, May 23, 1995).

Financial Management: Challenges Confronting DOD's Reform Initiatives (GAO/T-AIMD-95-143, May 16, 1995).

Defense Infrastructure: Enhancing Performance Through Better Business Practices (GAO/T-NSIAD/AIMD-95-126, Mar. 23, 1995).

DOD Procurement: Overpayments and Underpayments at Selected Contractors Show Major Problem (GAO/NSIAD-94-245, Aug. 5, 1994).

Defense Business Operations Fund: Improved Pricing Practices and Financial Reports Are Needed to Set Accurate Prices (GAO/AIMD-94-132, June 22, 1994).

Financial Management: DOD's Efforts to Improve Operations of the Defense Business Operations Fund (GAO/T-AIMD/NSIAD-94-146, Mar. 24, 1994).

DOD Procurement: Millions in Overpayments Returned by DOD Contractors (GAO/NSIAD-94-106, Mar. 14, 1994).

Financial Management: Status of the Defense Business Operations Fund (GAO/AIMD-94-80, Mar. 9, 1994).

Financial Management: Strong Leadership Needed to Improve Army's Financial Accountability (GAO/AIMD-94-12, Dec. 22, 1993).

Letter to the Deputy Secretary of Defense (GAO/AIMD-94-7R, Oct. 12, 1993).

Financial Management: DOD Has Not Responded Effectively to Serious, Long-standing Problems (GAO/T-AIMD-93-1, July 1, 1993).

Financial Management: Opportunities to Strengthen Management of the Defense Business Operations Fund (GAO/T-AFMD-93-6, June 16, 1993).

Financial Management: Navy Records Contain Billions of Dollars in Unmatched Disbursements (GAO/AFMD-93-21, June 9, 1993).

Financial Audit: Examination of Army's Financial Statements for Fiscal Year 1991 (GAO/AFMD-92-83, Aug. 7, 1992).

Financial Management: Immediate Actions Needed to Improve Army Financial Operations and Controls (GAO/AFMD-92-82, Aug. 7, 1992).

Financial Management: Defense Business Operations Fund Implementation Status (GAO/T-AFMD-92-8, Apr. 30, 1992).

Financial Audit: Aggressive Actions Needed for Air Force to Meet Objectives of the CFO Act (GAO/AFMD-92-12, Feb. 19, 1992).

Financial Audit: Status of Air Force Actions to Correct Deficiencies in Financial Management Systems (GAO/AFMD-91-55, May 16, 1991).

Defense's Planned Implementation of the \$77 Billion Defense Business Operations Fund (GAO/T-AFMD-91-5, Apr. 30, 1991).